

TIETÊ RIVER CLEANUP PROJECT, STAGE II

(BR-0265)

EXECUTIVE SUMMARY

BORROWER: Companhia de Saneamento Básico do Estado de São Paulo (SABESP) [State of São Paulo Basic Sanitation Company]

GUARANTOR: Federative Republic of Brazil and the State of São Paulo

EXECUTING AGENCIES: Companhia de Saneamento Básico do Estado de São Paulo (SABESP), State Ministry of Water Resources, Sanitation, and Works (SRHSO), and Companhia Estadual de Saneamento Ambiental (CETESB) [State Environmental Sanitation Company]

AMOUNT AND SOURCE:

IDB:	US\$200 million (OC)
Local counterpart funding:	US\$200 million
Total:	US\$400 million

FINANCIAL TERMS AND CONDITIONS:

Amortization period:	25 years
Disbursement period:	3 years
Interest rate:	Variable
Inspection and supervision:	1%
Credit fee:	0.75%
Currency:	U.S. dollars from the Single Currency Facility

OBJECTIVES: The project's objective is to improve environmental quality in the Tietê River watershed in the São Paulo Metropolitan Region (RMSP), conserving and making efficient use of water resources in the upper reaches of this basin, including a pilot program to reduce losses.

DESCRIPTION: The components of the project and their direct costs are as follows:

- Cleanup of the Tietê River. This subproject will consist of new intercepting sewers, pumping stations and piping to treatment plants, improvements at the Barueri treatment plant, and continuation of the plan to reduce pollution in the river being caused by industrial waste discharges (US\$85.2 million).
- Sewer systems, including wastewater collection works, trunk sewers, and residential and industrial connections in the RMSP (US\$189 million).
- Operational improvements in SABESP to help it run more efficiently. This will include development of appropriate sewage treatment and disposal technologies, setup of a data georeferencing system, monitoring of trunk sewers, and a residential connections program. In addition, a

pilot program will be carried out under which the necessary field equipment will be provided to study the efficiency of loss reduction methods and measurement of parameters to determine their economic viability. This study will serve as a basis for sizing a broader program (US\$25.8 million).

- d. Studies: (i) strategy development for the state of São Paulo basic sanitation sector, to identify opportunities for private-sector involvement and map out the roles of the public and private sectors in developing basic sanitation in the state (US\$3 million); and (ii) pricing for rational water use, which will include long-range marginal cost studies of the independent water and sewer systems of each SABESP business unit, to guide the pricing of these utilities (US\$4 million). Also to be funded under this component is an environmental education program designed primarily to raise the awareness of RMSP residents of the importance of proper garbage disposal in the effort to clean up the Tietê River (US\$1.5 million).

**SOCIAL AND
ENVIRONMENTAL
REVIEW:**

The planned works related to sewage collection, interception and treatment and control of industrial effluent discharges will improve water quality in the Tietê River within the RMSP, whereupon water in this area can be put to multiple uses. In addition, when stages II and III are completed, the total stretch of the river having dissolved oxygen content will increase, with the concomitant reduction of odors and ultimate esthetic improvements. Additional expected benefits are the use of recycled water by industry and electric power production at the Billings reservoir.

Some of the environmental impacts during construction are expected to affect city activities, requiring the rerouting of traffic and causing noise, dust, and perhaps runoff of solids into the river, but these would be temporary, localized, direct, and reversible. Some of the impacts would be eased by measures set out in the technical specifications for construction requested by SABESP from the contractors. Other measures will be put into place as a result of recommendations of the environmental impact assessments (EIAs) to be produced for the more complex works, which will be reviewed by the State Environment Ministry before startup permits are issued; they will also be included in bid documents.

The permit for the three stages of the Tietê project was issued on November 27, 1991. The EIA was released for public comment on November 14, 1991. On July 21, 1998, the Environmental Board recommended that actions to implement stage II of the Tietê River cleanup project go forward. The environment and social impact report was sent to the Bank's Public Information Center on September 16, 1998.

BENEFITS:

The project would produce the following benefits:

- a. The percentage of sewage collected in the RMSP and treated would rise from 48% to 55%.
- b. 400,000 additional households would be hooked up to the sewer system (estimated number of current residential hookups: 3.85 million).
- c. 290 additional industrial plants would come under the CETESB monitoring program (the agency currently monitors 1,250 such companies).
- d. Parameters would be identified for use in preparing a broader program to reduce losses in the RMSP.

RISKS:

The following are the chief risks of the operation:

- a. Trash collection. The garbage collection system, which is the responsibility of the Municipality of São Paulo, might not become more effective if the public continues to dump its trash into the streams flowing into the Tietê. Likewise, streets could continue to be dirty if the public is not motivated to keep them clean. The environmental education component of the proposed project, to be coordinated with the Municipality, would attenuate this risk.
- b. Industrial pollution abatement. To be successful, this second stage in cleaning up the Tietê will require the pooled efforts of the community for residential waste treatment (via SABESP) and of industry to obey the laws governing effluents. There is a risk that some plants, because of financial constraints or for other reasons, may be unable to make the investment outlays needed to lower pollutant loads currently being released into watercourses in the watershed. However, to judge by the success of the industrial pollution control plan that was part of the first stage of this project, which has instituted controls over the 1,250 industrial firms included in the plan, the aforementioned risk is unlikely to materialize.
- c. Works in municipalities not under SABESP control. Works required for the Tietê River cleanup in municipalities in which SABESP is not the concessionaire might not be completed in stage III of the project. To counter this risk, during stage II proposed herein, SABESP would send draft agreements to those municipalities to pave the way for execution of any such works during stage III.

**THE PROJECT'S ROLE
IN THE BANK'S
COUNTRY AND SECTOR
STRATEGY:**

The focus of the Bank's policy on public utilities is the long-range stability of these services. A climate conducive to investment and credit is seen as a requisite for stability, as is the promotion of competition for the market one condition for the latter being the adoption of a sound public utilities regulatory framework. The state of São Paulo is

developing such a framework for water supply and for sewage collection, treatment and disposal; the process is expected to end in approval of legislation to this end in the first half of 2000. Discussions are also under way at the national level as to which jurisdiction (state or municipal) should have the authority to award concessions in metropolitan regions. In the short term, this uncertainty on the legal and institutional front is dampening private-sector interest in sanitation operations in the RMSP.

Given the current water-resources picture in the state of São Paulo, the recommended project design is one that would conserve and make efficient use of the state's water resources, cleaning up its watercourses and taking the benefits of stage I of the Tietê project to the rest of the state. Because the sewage treatment systems planned for a number of localities in the interior and on the coast could be attractive to private operators, financing would best be confined to investments within the RMSP that, under current conditions and in the short term, would elicit little interest from the private sector. This includes sections of collecting and intercepting sewers and outfalls to convey sewage to existing treatment plants or facilities now being built, as well as works to expand sewer networks already in operation, and others which are less likely candidates for private-sector concessions because it is difficult to measure the service provided.

Because of the reduction the overall volume of investment project lending to Brazil in 1999, the Brazilian government decided to approve the financing of US\$200 million to continue with the project. The works for this stage were selected from among those representing benefits with the highest net present value.

Accordingly, the proposed project would concentrate on funding stage II of the Tietê project works in the RMSP, for which the Bank has been providing support since 1992. Using project funds, the State Ministry of Water Resources, Sanitation, and Works (SRHSO) would commission a study to identify possibilities for private-sector participation in basic sanitation in the state, and the best strategy to that end. The study's findings could help in mapping out the Bank's involvement in a future stage or stages of sanitation projects in the state of São Paulo, within an updated strategy framework.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

The following would be conditions precedent to the first disbursement of funds for each component.

SABESP would be required to demonstrate that it had executed agreements with the following parties: (i) with the SRHSO, laying down conditions for the transfer of funds and repayment of debt corresponding to the study on basic sanitation sector strategy development for the state of São Paulo, and (ii) with CETESB, stipulating conditions for the transfer of funds and repayment of the debt corresponding to the

industrial pollution control component (paragraph 3.10 of the loan proposal which follows).

Special conditions for this operation would be as follows:

Within six months:

SABESP would present: (1) a plan of actions to be taken to collect overdue amounts from municipal licensees, and the expected collection targets (paragraph 4.27); and (2) evidence that the project management firm has been hired (paragraph 3.1).

During the project execution period:

(1) SABESP's short-term indebtedness from borrowings is not to exceed 8.5% of its equity (paragraph 4.31) and (2) SABESP's rates must be high enough to bring in revenues to defray all its operating expenses and it must achieve a 7% return on fixed investment (paragraph 5.13).

The loan contract will include clauses regarding environmental requirements on water quality and industrial pollution control, the hiring of short-term consultants, auditing, progress reports, monitoring, and evaluation.

**RECOGNITION OF
EXPENDITURES AND
RETROACTIVE
FINANCING:**

SABESP has asked the Bank to recognize, as retroactive financing, expenditures of up to the equivalent of US\$1,554,000 incurred for works for the project after September 15, 1998. It has also requested recognition, as a local counterpart contribution, of up to the equivalent of US\$3,076,700 spent after March 15, 1998, to prepare the project.

**SOCIAL EQUITY AND
POVERTY REDUCTION
CLASSIFICATION:**

This operation qualifies as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Furthermore, this operation qualifies as a poverty-targeted investment (PTI) (see paragraph 5.29). The borrower will not be using the 10 percentage points in additional financing.

**EXCEPTIONS TO BANK
POLICY:**

By request of the Government of Brazil, the guarantee contract will not contain any federal government guarantee to supply local counterpart resources or to answer for any obligation of the borrower that is not within the purview of the federal government. This decision was made in light of constitutional provisions and laws in Brazil. The State of São Paulo, majority shareholder of the borrower, will provide the guarantee in respect of counterpart and performance obligations.

**PROCUREMENT OF
GOODS AND
CONTRACTING OF
CONSTRUCTION AND
CONSULTING
SERVICES:**

The Bank's current policy on procurement of goods, construction contracting, and hiring of consultants that are to be paid for with project funds will apply. When funds from the Bank's loan are to be used, the thresholds above which international competitive bidding will be mandatory are US\$5 million for construction contracts and US\$350,000 for goods and associated services. For consulting services, the threshold for international competitive bidding will be US\$200,000.